No. 3011

IN THE

United States Circuit Court of Appeals

For the Ninth District

IN THE

MATTER OF THE PHOENIX HARDWARE COMPANY, A CORPORATION, BANKRUPT.

J. B. LONG, J. W. LONG, MARGARET M. LONG, AND M. WEST,

Appellants,

vs.

CHARLES B. CHRISTY, as Trustee of the Estate of PHOENIX HARDWARE COMPANY, a corporation, Bankrupt,

Appellee.

Brief of Appellee

J. C. FOREST,
Solicitor for Charles B. Christy, as Trustee of the Estate of Phoenix Hardware Company, Bankrupt, Appellee.

R. A. Watkins Printing Co., Inc., Phoenix, Ariz.

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BRIEF OF APPELLEE

On Appeal From the United States District Court for the District of Arizona

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This is an appeal by J. B. Long, J. W. Long, Margaret M. Long, and M. West from the orders and decrees of the United States District Court for the District of Arizona, dated March 3d, 1917, which orders and decrees, after an amendment in an important particular, affirmed the orders and decrees of the Referee in Bankruptcy, dated March 15th, 1916.

Appellants have failed to file a brief herein, and

under sub-division 5, Rule 24, this appeal may be dismissed, but appellee does not move to dismiss for the reason:

FIRST: Appellee prays for an order and decree affirming the orders and decrees herein, as amended by the Judge of the District Court, on review, or if in the opinion of this Court the amendment of said orders and decrees was improvidently made, that then said orders and decrees be modified so as to conform to the original orders and decrees made by the Referee, and as so modified affirmed.

Phoenix Hardware Company was organized under the laws of Arizona in March, 1907, with a capital stock of $50,000.00 divided in 500 shares, par value $100.00 each, and conducted a general hardware and implement business at Phoenix, Arizona.

That on March 19th, 1907, the appellants (who are the only stockholders in said corporation), each subscribed for the following number of shares:

M. West	250 Shares
J. B. Long	130 Shares
J. W. Long	80 Shares
Margaret Long	40 Shares

and certificates as for full paid shares were issued to them.

On October 24th, 1914, Phoenix Hardware Company was adjudged a bankrupt, and on November 20th, 1914, Charles B. Christy qualified as Trustee of said bankrupt estate.

Claims aggregating $5835.00 were filed and allowed against said estate and the Trustee, after disposing of all property of said estate, has in his hands $377.94 applicable to the payment of these claims, also subject to the payment of costs, disbursements, commissions and counsel fees, and the referee estimates the costs, disbursements, commissions and counsel fees to be $665.00 (R. p. 97).

On October 25th, 1915, the said Trustee filed a petition with the Referee in Bankruptcy, Fred A. Larson, alleging inter alia, that each of said subscribers had paid but 20 per cent of the par value of the stock in said corporation Bankrupt purchased by them, and no more, and praying for an order directing him to make an assessment and call upon the stock of said corporation, bankrupt, for the purpose of paying the debts of the Bankrupt (R. p. 1-10).

That a hearing was had on said petition, and such proceedings were had thereon, that, on the 15th day of March, 1916, the said Referee made and entered

an order and decree (R. p. 95-105), dcreeing that each of said appellants are liable to the Trustee of said Bankrupt Estate in the sum of 33 per cent of the par value of the stock owned by them, less the amount paid thereon.

That upon petition for review, the case was certified to the District Judge, who, after amending the orders and decrees of the Referee to the effect that the liability was **joint** and **several, affirmed** the said orders and decrees as amended.

The Referee found as a matter of fact (R. p. 16), that appellants paid $10,000.00 for the entire capital stock of said company, and with said sum the Phoenix Hardware Company, bankrupt, purchased a stock of goods from Arizona Hardware and Vehicle Company. The evidence sustains this finding (R. p. 52-53), (R. p. 91).

The Referee further found that 80 per cent of the par value, or $80.00 per share of said stock remains unpaid (R. p. 16).

ASSIGNMENT OF ERRORS NOS. 1 AND 9.

The Bankruptcy Court may make assessment and call, and the proper practice in such cases is for the Trustee to file petition in the Bankruptcy Court for an order directing him to make an assessment and call upon the unpaid stock of the corporation for the

purpose of paying its debts. In order to determine whether such an order should be made, it is necessary for the Court to examine into and decide certain questions of fact, that is whether at the time of issue of any particular share, the full value was or was not paid in, whether any subsequent payments were made on account of it, whether the corporation was indebted in excess of the assets, and what is the amount of its indebtedness.

Scoville vs. Thayer, 105 U. S. 143, 26 L. Ed. 968.

1st Remington on Bankruptcy, Sec. 976 and 977.

ASSIGNMENT OF ERRORS NOS. 2, 4, AND 5.

Stockholders become such in several ways: Either by original subscription, or by assignment of prior holders, or by direct purchase from the Company.

Webster vs. Upton, Assignee, 91 U. S. 65, reading page 67.

Upton, Assignee, vs. Tribilcock, 91 U. S. 45.

Sanger vs. Upton, Assignee, 91 U. S. 56, reading page 63.

One who stands upon the books of the Company as a stockholder may be proceeded against for the recovery of any sum due upon the stock.

Sanger vs. Upton, Assignee, **supra.**

Paragraph 776 R. S. Arizona, 1901, reads as follows:

> "Nothing herein shall exempt the stockholders of any corporation from individual liability to the amount of the unpaid installments on the stock owned by them, or transferred to them for the purpose of defrauding creditors; and an execution against the corporation to that extent may be levied upon the private property of such individual."

Paragraph 2109 R. S. Arizona Civil Code, 1913, is substantially the same.

Where a corporation issues stock in payment for property, the property must be the fair equivalent in value of the par value of the stock issued therefor, otherwise the stockholder receiving it is liable to creditors who become such without knowledge of the fact, for the difference, whether he was guilty of actual fraud or acted in good faith; and, as a creditor dealing with a corporation had the right to rely on its having the full amount of its capital stock in money, or its equivalent value, in a suit to enforce such liability, the burden rests on the defendant to prove that plaintiff knew that it did not.

Babbitt vs. Read, 215 Fed. 395, affirmed by (C. C. A.) 236 Fed. 42.

Van Cleve vs. Berkey, 143 Mo. 109; 44 S. W. 743.

While these cases rests to some extent on constitutional and statute law, the great weight of authority seems to be that, even in the absence of statutory law, unpaid subscriptions to the capital stock of a company is a **trust fund** for the benefit of the creditors of a corporation, and a trustee in bankruptcy may enforce collection of same.

Hatch vs. Dana, 101 U. S., 205.

Scoville vs. Thayer, **supra**, and cases heretofore cited in 91 U. S.

The only expression of the Supreme Court of Arizona on any of the questions involved in this cause is found in the case of Stiles, Assignee, vs. Samaniego, 3d Arizona, 48; 20 Pac., 607.

The main proposition upon which reliance is had to reverse the decree of the Bankruptcy Court, is that a stockholder who has turned into the corporation property in payment of his stock, which has been accepted by the corporation as the equivalent of the face value of the stock, and who has not been guilty of actual fraud, cannot be called to account by creditors of the concern, or made to pay in satisfaction of debts the difference between the value of the property turned in and the par value of the

stock, and in support of this proposition the cases of Clark vs. Beaver, 139 U. S. 96; and Fogg vs. Blair, 139 U. S. 118, were cited by appellants in the Court below. These two cases, while they hold that the capital stock of a corporation, especially its unpaid subscriptions, is a trust fund sub modo for the benefit of its general creditors—they also hold a corporation may in good faith sell or dispose of its stock **to creditors in discharge of their debts** at less than par, where the corporation is financially embarrassed. These cases are not in point as the evidence clearly shows that at the time appellants purchased their stock the Phoenix Hardware Co., bankrupt, had no creditors. The case of Camden vs. Stuart, 144 U. S., 104; and Babbitt vs. Reed, 215 Fed. 395, affirmed on appeal by C. C. A., 236 Fed. 42, discuss these cases, and point out clearly their limitations and just what they intended to decide. In the case of Camden vs. Stuart, the Court, at pages 113 and 114, says:

> "Nothing that was said in the recent case of Clark vs. Beaver, 139 U. S., 96; Fogg vs. Blair, 139 U. S. 118, or Handley vs. Stutz, 139 U. S. 417, was intended to over-rule or qualify in any way the wholesome principle adopted by this Court in the earlier cases, especially as applied to the original subscribers to stock."

> "The later cases were only intended to draw a line beyond which the Court was unwilling to go in affixing a liability on those who had purchased stock of the corporation, or had taken it in good faith in satisfaction of their demands."

ASSIGNMENT OF ERROR NO. 3.

It is discretionary with the trustee as to whether book accounts shall be abandoned because not collectable.

> 1st Remington on Bankruptcy, Sec. 932-933.
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> Atchison, etc. R. R. Co. vs. Hurley, 153 Fed. 503.
>
> Watson vs. Merrill, 136 Fed., 359.
>
> In re Jersey Island Packing Co., 138 Fed., 625 (9th Circuit).

ASSIGNMENT OF ERROR NO. 6.

Assignment of Error No. 6 begs the question; but Courts will look to the substance rather than the shadow of a transaction.

While there is no book record of the stock transaction in this respect, the evidence shows (Transcript Record, Pg. 52-53), that the Phoenix Hardware Co. derived title of the stock of merchandise in question by bill of sale from Arizona Hardware & Vehicle Co. (R. p. 52-53), (R. p. 91). Now, whether or not the physical act of placing the money

in the treasury of the bankrupt company and the payment of it by Phoenix Hardware Co. to the Arizona Hardware & Vehicle Co. for the stock of goods, it is **in effect** what was done, as found by the referee. Even though the organization of the Phoenix Hardware Co. had not been perfected at the time of the stock transaction, appellants contemplated its organization (R. p. 91), perfected its organization, and it received and became the owner of the stock of merchandise by virtue of the bill of sale from the Arizona Hardware & Vehicle Co., and the particular manner in which the transaction was carried out cannot be successfully urged to defeat the well-established rule that "the capital stock of a corporation is a trust fund for the benefit of its creditors," and that property transferred to a corporation in payment for its stock must be the fair equivalent in value to the par value of the stock.

ASSIGNMENT OF ERROR NO. 7.

By their Assignment No. 7, appellants contend that the evidence does not show that at the time they purchased their stock the amounts paid thereon were credited to them, and the balance unpaid credited to discount, and the stock account between the company and themselves balanced by such discount. True there was no book record of such stock ac-

count, as the company kept no such account. But the evidence clearly shows that they purchased their stock at 20 per cent of its par value, and certificates as for full paid shares were issued and delivered to them, and whether there was any book account of the transaction or not, the very nature of the transaction shows clearly that the company must **in effect** have done just what the referee found it did do.

> Scoville vs. Thayer, **supra,** reading page 144.

The general rule is that the findings of fact by a referee will not be disturbed by a judge unless they are clearly erroneous.

> In re Covington, 110 Fed., 143.
> In re Lefleche, 109 Fed., 307.
> In re Stout, 109 Fed., 794.

ASSIGNMENT OF ERROR NO. 8.

In answer to Assignment of Error No. 8, the Court's attention is again directed to the case of Scoville vs. Thayer, **supra,** where, in speaking on the question of representation to the public that its stock was, or would be, fully paid, the Court, at page 154, said:

> "It is so held out to the public, who have no means of knowing the private contracts made between the corporation and its stockholders."
>
> "The creditor has, therefore, the right to

> presume that the stock subscribed for has been, or will be paid up; and if it is not, a **Court of Equity** will, at his instance, require it to be paid."
>
> "In this case the managers and agents of the bankrupt company had **in effect,** represented to the public that all its capital stock had been subscribed for, and had been, or would be, paid in full."

It is clear from the opinion last cited that it is not necessary that the managers and agents of the corporation must represent to each individual creditor dealing with it that its capital stock is paid in full before a creditor is warranted in indulging in the presumption that such stock has been so paid up; it is sufficient if the corporation has been as in this case, doing business with the public for years, under published and recorded articles of incorporation showing a capitalization of fifty thousand dollars.

> Babbitt vs. Read (C. C.) 173 Fed., 712.
>
> In re Remington Automobile and Motor Co., 153 Fed., 345.

ASSIGNMENT OF ERROR NO. 10.

The statute of limitation does not run against creditors' claims for unpaid subscriptions until a valid call is made by the directors, or by a court of competent jurisdiction, or some authorized demand is made upon the share-holders.

> Scoville vs. Thayer, **supra,** reading page 153.

ASSIGNMENT OF ERROR NO. 11.

Upon petition for review the Judge of the District Court (upon the authority of Babbitt vs. Read, 215 Fed., 395, reading page 416, affirmed by C. C. A. 236 Fed. 42), amended the orders and decrees made by the Referee to the effect that the liability of appellants is **joint and several.**

Babbitt vs. Read, **supra,** is a case where the Trustee of a bankrupt estate brought suit against the stockholders to compel them to pay over to the Trustee a sufficient amount of money to pay the general creditors of the bankrupt corporation, on the grounds that the stockholders had not paid the par value of their stock, and ordered that a **joint and several** decree be entered against them (p. 416).

In the case of Hatch vs, Dana, 101 U. S., 205, Dana recovered a judgment against the Chicago Republican Company, and an execution having been returned nulla bona, Dana, on behalf of himself and other creditors, exhibited his bill in equity against the Company, Hatch, Williams and other stockholders, alleging inter alia, that 80 per cent of the par value of their stock had never been paid in to the Company, and while the Court held that the stockholders were liable for the unpaid subscriptions for

their stock, the liability was several only, and not joint and several .

Converse vs. Hamilton, 224 U. S., 240, seems to take the same view though but very little is said by the Court on this point.

Note to Thompson vs. Reno Savings Bank, 3rd Am. State Rep. 852, et seq.

ASSIGNMENT OF ERROR NO. 12.

Appellee submits that the facts found by the Referee, and the orders and decrees based thereon are fully supported by the evidence in this case (R. p. 24-81).

WHEREFORE, all things considered plaintiff and appellee pray this Honorable Court that the orders and decrees of the District Court for the District of Arizona made and entered on the 3rd day of March, 1917, be affirmed.

J. C. FOREST,
Solicitor for Charles B. Christy, as Trustee of the Estate of Phoenix Hardware Company, Bankrupt, Appellee.